COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION PURSUANT TO KRS 278.260 OF THE EARNINGS SHARING MECHANISM TARIFF OF KENTUCKY UTILITIES COMPANY	)	CASE NO. 2003-00334

AND

AN INVESTIGATION PURSUANT TO KRS 278.260 OF THE EARNINGS SHARING MECHANISM TARIFF OF LOUISVILLE GAS AND ELECTRIC COMPANY	)	CASE NO, 2003-00335

INITIAL REQUEST FOR INFORMATION OF THE ATTORNEY GENERAL

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and submits these Requests for Information to BWG, to be answered by the date specified in the Commission's Order of Procedure, and in accord with the following:

(1) In each case where a request seeks data provided in response to a staff request, reference to the appropriate request item will be deemed a satisfactory response.

(2) Please identify the witness who will be prepared to answer questions concerning each request.

(3) These requests shall be deemed continuing so as to require further and supplemental responses if the company receives or generates additional information within the scope of these requests between the time of the response and the time of any hearing conducted hereon.

(4) If any request appears confusing, please request clarification directly from the Office of Attorney General.

(5) To the extent that the specific document, workpaper or information as requested does not exist, but a similar document, workpaper or information does exist, provide the similar document, workpaper, or information.

(6) To the extent that any request may be answered by way of a computer printout, please identify each variable contained in the printout which would not be self evident to a person not familiar with the printout.

(7) If the company has objections to any request on the grounds that the requested information is proprietary in nature, or for any other reason, please notify the Office of the Attorney General as soon as possible.

(8) For any document withheld on the basis of privilege, state the following: date; author; addressee; indicated or blind copies; all persons to whom distributed, shown, or explained; and, the nature and legal basis for the privilege asserted.

(9) In the event any document called for has been destroyed or transferred beyond the control of the company, please state: the identity of the person by whom it was destroyed or transferred, and the person authorizing the destruction or transfer; the time, place, and method of destruction or transfer; and, the reason(s) for its destruction or transfer. If destroyed or disposed of by operation of a retention policy, state the retention policy.

Respectfully Submitted,
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CERTIFICATE OF SERVICE AND NOTICE OF FILING

I hereby give notice that this the 26th day of Septmeber, 2003, I have filed the original and ten copies of the foregoing with the Executive Director of the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 and certify that this same day I have served the parties by mailing a true copy of same, postage prepaid, to those listed below.

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Request for Information to BWG
From the Attorney General
Case No. 2003-00334
Case No. 2003-00335

1. Refer to the FINAL REPORT (Report), page I-2, the first paragraph in the section entitled "B. Overall Assessment." Is a stable ROE a desired goal since, in the capital market, capital costs change and this could deny the Companies access if capital costs in the capital market are above the upper dead-band limit? Conversely, if market cost rates are below the lower dead-band limits, there would be an incentive to diversify into potentially undesirable projects.

2. Refer to page I-2, the second paragraph in the section entitled "B." Should the Commission allow a periodic review of the recalibration of the allowed return on equity because if the Commission does not allow a recalibration, could this hinder the service obligation when market cost rates are higher than the upper dead-band limit?

3. Refer to page I-2, the last paragraph on the page. Please explain how "an economic/risk-based capital budgeting process" is consistent with "a reliability-centered asset management program?"

4. Refer to page I-2, the last paragraph on the page that is continued at the top of page I-3. Would it be appropriate to conclude that the improved service reliability is independent of the ESM and that the ESM neither provided an incentive nor a disincentive for service reliability in light of potentially rising or falling capital cost rates?

5. Refer to page I-9, the paragraph that starts at the bottom of the page and continues at the top of page I-10. This paragraph states that one "COSR flaw" is "to promote growth and maximize the utilization of existing plant" which causes the need to build "higher cost plant" which in-turn causes rates to increase.

a. Should the term "promote growth" be more appropriately phrased as "promote growth by encouraging the inefficient use of electricity?"

b. How is the promotion of growth through the efficient use of electricity undesirable regardless of the effect on the local economy?

c. What is the effect of allowing CWIP in the rate base and the use of AFUDC accounting between rate cases an incentive or disincentive in COSR?

d. Explain how meeting permanent (base) load growth with combustion turbine units is desirable?

6. Refer to page I-9, the paragraph that starts at the bottom of the page and continues at the top of page I-10 and explain how the ESM design corrects or exasperates this "COSR flaw."

7. Refer to the next to the last paragraph on page I-10. Here the Report indicates that the Companies have significant under-earnings in 2002 and will "remain in an under-earning position for the next several years." Please explain the effect of several years of under-earning with the hope of only recovering 40% of the under-earnings on:

a. Capital costs?

b. Dividends to E.On US?

c. Maintenance of existing plant?

d. Construction of T&D plant?

e. Building base-load, low operating cost generation plant?

f. Service reliability?

8. Is BWG aware that the Companies retain the statutory right to seek a base rate increase in the event of under-earning and have stated that they will do so if necessary? Should continued under-earnings cause the companies to seek and increase in base rates during the term of an ESM, what effect would the increase in base rates have on the symmetry of the operation of the ESM and on the fairness of the 60/40 sharing of over- and under-earnings?

9. Refer to the last paragraph on page I-10. Why should O&M Expense per Customer be in line with customer growth?

10. Refer to the graph on page I-11. Transmission cost is graphed on a "per-customer" basis. Would the graph be the same on a "per-Mwh" basis?

11 Refer to the graph on page I-13. A&G Costs are shown on a "per-Mwh" basis. Would the graph be the same on a "per-Customer" basis?

12. Refer to the next to the last paragraph on page I-13. Did BWG perform any evaluation to determine the reasonableness of the "MISO-related" (Midwest Independent System Operator) expenses?

13. Since the MISO related expenses are start-up costs, shouldn't these be capitalized and amortized over a period of time?

14. Refer to the two graphs on page I-12. Both graphs show that "Cost(s) per Customer increased in the year 2002. What were the causes of these cost increases?

15. Refer to page I-15, the next to the last paragraph on the page. Here the Report indicates that "ratepayers receive the benefit of lower interest rates" when interest rates fall and "shareholders are protected in periods of rising interest rates." From a ratepayer's perspective, is this a perverse weakness of the ESM because ratepayers may have more disposable income to pay electric bills during periods when interest rates are low, and less disposable income to pay electric bills during periods of high interest rates?

16. Refer to page I-18, "Task Area 1 – Affiliate Transactions." Please state for each finding, 1 through 5, whether each is considered to be a strength or a weakness.

17. Refer to page I-22, the section on "Affiliate Transactions," the recommendation given as priority A. Is it really possible to create a position, that has objectives contrary to the interest of the shareholders, that would not have conflicts of interest?

a. who would the person holding this recommended position report to?

b. How would that person's performance review be determined?

c. how would the salary of the person holding the recommended position be determined?

18. Refer to page I-19, the findings for "Task Area 2 – Management Practices" and to Page I-22, the recommendations for "Task Area 2 – Management Practices." Please relate each recommendation for the "Management Practices" to the findings for "Management Practices."

19. Refer to page I-22, "Management Practices." The second paragraph states that, "The allowed rate of return is set by a deliberative process that is intended to provide adequate financing for the operating utilities and a fair return to investors. When the allowed rate of return is not achieved, it jeopardizes the utilities' financing capability and shortchanges the investors, in this case, E.On."

a. Is this a finding or a recommendation?
b. Should the annual filings be accompanied by a deliberative return on equity finding?
c. Specifically, what is the recommendation associated with this paragraph?
d. Does this paragraph simply provide emphases for the need to tie the short-term incentive program to the ESM?

20. Refer to page I-19, the findings for "Task Areas 3 and 4 – ESM Structure." The third finding of the Report indicates that, "Business and regulatory risk are reduced by the ESM adjustments to rates as the return on equity deviated from the dead-band. The ESM tends to stabilize the return on equity."

a. How should the return on equity be adjusted when it is established using comparable companies?

b. Should the target return on equity be reduced because of the smaller business and regulatory risk premium?

c. If the answer to part b is yes, please explain.

d. If the answer to part b is no, please explain.

21. Refer to page I-15, the paragraph beginning with "Exhibit I-7." Here it is stated that, "Changes in the weighted average cost of capital can occur as a result of changes in interest rates or capital structure." On page I-20, a finding in the Report indicates that a weakness of the ESM is that it "provides no direct control over financing costs or capital structure."

a. Why isn't there a recommendation on page I-23 that deals with capital structure?

b. Would a capital structure control be desirable?

c. If the answer is yes, what type of control would BWG recommend?

d. If the answer is no, please elaborate on the "other means to exert control" that the Commission has to control the capital structure.

22. Does BWG consider these "other means" that the Commission has to control the capital structure effective?

a. If yes, please elaborate.

b. If no, please elaborate.

23. Has BWG considered other measures of performance other than return on equity since this measure requires the use of a capital structure and interest rates in its calculation?

24. If the answer to the previous question is yes, what other measures were considered?

25. Refer to page I-23, "ESM Structure." Please relate the three recommendations to the five weaknesses shown at the top of page I-20.

26. Refer to page I-23, "ESM Structure." The first recommendation suggests that a "multi-year" ESM be used to reduce the effect of timing issues. This recommendation is discussed further on page V-8, item 1.

a. Specifically, how many years does BWG recommend be used?
b. Does this recommendation envision an annual filing or a multi-year filing?

27. Refer to the first audit objective on page II-1 in the Report. This objective specifically requests that the efficiencies be tied to the ESM incentive plan. Now refer to the findings listed on pages I-18 through I-21. Identify the findings shown on these pages that indicate that the ESM has provide the incentives or otherwise caused the companies to initiate efficiencies.

28. Refer to the second audit objective on page II-1 in the Report. This objective specifically asks what effects the ESM plan has had on service levels. Refer once again to the findings listed on pages I-18 through I-21 and identify which findings indicate that the companies have increased their service level as a result of the ESM plan.

29. Refer to page III-2 in the Report, the next to the last full paragraph on the page. The Report indicates that substantially all product and service transactions among LEC affiliates are processed through Servco. Now refer to Exhibit 1 – 1, on page 1-4. Where does Servco fit on the Corporate Organization Chart?

30. If an informal decision-making organization chart was presented (rather than a corporate organization chart), would Servco be positioned where LG&E Energy Corp. is positioned in the Corporate Organization chart shown in Exhibit 1-1 on page 1-4?

31. Refer to page III-2 in the Report , the next to the last paragraph on the page. The Report indicates that "LGE was allocated $95 Million and KU was allocated $75 million.

a. What allocation method was used to distribute the joint costs?
b. What steps did BWG take to assure that the allocation method that was used is appropriate given the nature of the costs that were involved?
c. Was any attempt made to examine the trend in these costs as was done on pages I-11 and I-12 of the Report?
d. Would it be correct to say that LG&E and KU accounted for 54% of Servco's cost ($335 million divided by $616 million) rather than "about 50% of Servco's costs?"

32. Refer to page III-3, the last paragraph on the page. The report states that, "From 2001 forward, the payment of dividends became principally a tool for managing the operating

companies' capital structures to conform with the Merger Agreement and to maintain financial credit ratings."

a. What capital structure does the Merger Agreement require?

b. How did BWG determine that the capital structures of LG&E and KU will maintain the Companies' financial credit ratings?

c. In BWG's evaluation, what is the optimal capital structure for LG&E?

d. In BWG's evaluation, what is the optimal capital structure for KU?

e. The Report, on page I-20, indicates that the Commission can exert control over the Companies' capital structure. Can the Commission control the amount of dividend payment that the Companies make?

f. What is meant by keeping the "capital structures of the operating companies in balance?"

33. Refer to page V-10, Exhibit V-3. The capital structure shows that LG&E has an equity component of approximately 50%. KU has an equity component of approximately 60%. KU has approximately 10 percentage points more equity than LG&E.

a. How does this conform with the statement on page III-3 that dividends are used to keep the capital structures in balance when in 2002 KU paid no dividends and LG&E paid $69 million?

b. Since KU paid no dividends in 2002, did the equity component in its capital structure increase?

c. Does BWG believe that is reasonable for KU to have 10 percentage points more equity than LG&E?

d. Should both companies have the same target ROE when KU has less financial risk than LG&E?

34. Refer to page III-4, Exhibit III-4 and the text under the Exhibit. It is indicated that LG&E and KU paid $329.3 million in taxes to LEC.

a. Was this a cash payment or was a portion of the amount deferred?
b. If a portion of the $329.3 million was deferred, how do the operating companies account for deferred taxes?
c. Do LG&E and KU include deferred taxes in the annual ESM filings?

35. The text under Exhibit III-4 indicates that LEC paid $23.3 million to the U.S. Treasury in 2000 and 2001. In addition, LEC paid 22.7 million to Powergen in 2002 even though Powergen had no tax liability in 2001 and 2002. If the LG&E payments and the KU payments were cash payments, where does the money go? E.g. Does it get loaned back to the operating companies or other affiliated companies or what?

36. Refer to page III-4, the next to the last paragraph on the page. It is stated that Powergen provides back-up LEC cash pool lending when E.ON North America cannot meet the needs.

a. Is one of the sources of funds that Powergen loans derived from the operating company tax payments?
b. If the answer to part a. is yes, what is the interest rate charged on these funds?

37. Refer to page III-4, the bottom paragraph on the page. If Ergon is a captive Powergen insurance company, why is Risk Management Services, a non-affiliated company, used by Servco?

38. Refer to item 3 on page III-8. Are the Service Level Agreements "not used as intended" or are they simply not used.

39. Refer to page III-9, item 5 which states that the basis for costing and pricing transactions between LG&E/KU and affiliates is appropriate and supported ... and there is no cross-subsidization between regulated and non-regulated affiliates.

a. What independent tests did BWG perform to substantiate that the basis for costing and pricing transactions between the operating companies and affiliates are appropriate?
b. Was any reliance was placed on the Servco US Audit Services report described in the next to the last bulleted statement on page III-9 in concluding that the costing and pricing of transaction is appropriate and supported?
c. Is the conclusion of item 5 on page III-9 clouded by the findings of item 2 on page III-6?

40. Refer to page V-6, the first two bulleted paragraphs on the page which deal with "Large Capital Additions" and "Capital Structure." These are pointed out as weaknesses, and yet, the Report does not make any recommendations concerning these items. Why?